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SUBJECT: KAZAKHSTAN: NEW UNIFIED PROCUREMENT SYSTEM FOR
PHARMACEUTICALS

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11. (U) Sensitive but unclassified. Not for Public Internet.

12. (SBU) SUMMARY: According to the Ministry of Health's Pharmaceutical Control Committee, Kazakhstan's plan to consolidate most state procurement of pharmaceuticals under one provider will stimulate the economy and increase domestic pharmaceutical production. The World Bank expressed reservations about the new system, saying the government is reforming institutions too rapidly and not waiting for the World Bank's own health reform program to be approved. American Company UniPharm predicted that it will be difficult to establish an efficient distribution system, which will require setting up a huge storage capacity and sending drugs even to small villages in remote regions. UniPharm did not think the new plan will attract many foreign investors, especially those that would make "high-tech" insulin and antibiotics. END SUMMARY.

NEW PROCUREMENT LAW ALSO DESIGNED TO ATTRACT INVESTMENT

13. (SBU) Kazakhstan recently implemented a new unitary system to consolidate most state procurement of pharmaceuticals under a single distributor/provider. In addition, President Nazarbayev tasked the government in May to increase the market share of local pharmaceutical producers to 50 percent by 2014.

14. (SBU) According to Syzdyk Baimukhanov, Chairman of the Ministry of Health's Pharmaceutical Control Committee, the government hopes to save up to 40 percent of current budget expenditures on pharmaceuticals as well as stimulate domestic production. He said the government will give a purchase guarantee -- a five-year contract at a fixed price -- plus tax waivers to domestic producers. Baimukhanov said foreign companies (like Pfizer and Merck, for example) that choose to invest in Kazakhstan and produce locally will be fully regarded as domestic producers and will receive the same purchase guarantee and tax waivers. He said the main goal of the new plan is to attract investment to Kazakhstan and to produce inside Kazakhstan rather than continue to import expensive

pharmaceuticals from abroad.

NATIONWIDE PILOT PROJECT UNDERWAY

15. (SBU) Baimukhanov said a nationwide pilot project for the purchase and delivery of pharmaceuticals began in May. Distribution costs will not be a major factor in the overall cost of pharmaceuticals, he said, and early results show a savings of up to 45 percent in budget expenses. Public hospitals will place their orders with the central agency, which then purchases pharmaceuticals for public hospitals, taking advantage of bulk purchasing to lower costs. Hospitals can continue to order specialized medicines as needed throughout the year. There will still be a private sector for pharmaceuticals because the unitary procurement system is expected to handle only about 70 percent of total purchases for public hospitals.

SHOULD ALSO REDUCE OBLAST-LEVEL CORRUPTION

16. (SBU) Baimukhanov repeatedly cited Malaysia and Britain as models of efficiency. He said centralized procurement will mean less illegal redirection of pharmaceuticals and less local corruption from the previous system, where each oblast wanted to preserve its own non-transparent system of procurement, showing favoritism to certain local "distributors" who were able to purchase pharmaceuticals with government budget money and then sell them on the market, making a considerable profit.

17. (SBU) COMMENT: Baimukhanov is a former president of KhimPharm, the largest local producer of pharmaceuticals. KhimPharm won the pilot tender for production. StoPharm, a private distributor, won the pilot tender to deliver medicines, underbidding other bidders by 40 percent. StoPharm has been accused in the past of not fulfilling contractual obligations and winning tenders unfairly. The Ministry of Health even sent a letter to the Committee of Financial Control

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and State Procurement asking that this company be put on a list of unreliable service providers. END COMMENT.

WORLD BANK HAS CONCERNS

18. (SBU) World Bank Social Project Coordinator Bibigul Alimbekova and Health Sector Technology Transfer and Institutional Reform Project Administrative Coordinator Ninel Kadyrova told Regional Environmental Officer that they want to "step back" and wait before commenting further. Alimbekova said the government's intention is to protect the local population and provide the best medical product at the best prices possible. However, the government did not wait for the government's final agreement on the World Bank's own overall health reform program, part of which was to reform the pharmaceutical market before launching their unitary procurement system.

19. (SBU) Alimbekova said the World Bank believes that institutional reform cannot be done so quickly. She said the government wants to do this now and not wait, and it needs a fast turn-around, because it has an urgent agenda. She said Kazakhstan wants to be among the top competitive nations in the world, but she believes it cannot complete the entire pharmaceutical reform agenda in such a short time. She said "instant reform" cannot be done quickly, even if the order comes from the top. There is still a "Soviet mentality" that impels people to carry out these orders "or die (in the process)," she added.

110. (SBU) According to Kadyrova, the World Health Organization recommends that centralized procurement of pharmaceuticals comprise at least 50-60 percent of a country's procurement for inpatient care in order to take advantage of bulk purchases and, therefore, lower prices. Hospitals can make their bulk purchases through centralized procurement and smaller purchases can be done locally.

SYSTEM'S AUTHOR CONVINCED STATE WILL BENEFIT

111. (SBU) Serik Sultanov, President of the "PharmMed Industry of Kazakhstan" Association, member of President Nazarbayev's

Entrepreneur's Council, and an advisory member of SK-Pharmacia (the designated unitary distributor), told Regional Environmental Officer that he single-handedly authored the new unitary distributor initiative. He said he visited Malaysia in 2007 to learn about their single-operator system and was struck by how much more efficiently and cheaply Malaysia procured medicines than Kazakhstan.

It spent about the same amount of money for a population almost twice as large and procured 70 percent more medicines than Kazakhstan.

¶12. (SBU) Sultanov said Kazakhstan's pharmaceutical market is about one billion dollars, 50 percent of which is state procurement of medicines. Under the current system, local distributors now purchase directly from producers, using state budget allocations, and then make a 100 percent profit selling the medicine at retail. This leads to excessive corruption, he said, whereby state procurement has become a "feeding trough" for government officials. For example, a hospital's head doctor can set up his own distributing company and then give it his hospital's contract to provide medicine. By contrast, under the new system, the single distributor will purchase medicines directly from producers, thereby allowing them to avoid excessive retail margins.

SK-PHARMACIA EXPLAINS ITS ROLE

¶13. (SBU) SK-Pharmacia Deputy Director General Aibar Burkitbayev told Regional Environmental Officer that the Ministry of Health previously had national and regional programs to procure medicines for public hospitals. A Ministry of Health survey showed significant regional variances in the prices of medicines, he said, resulting in huge budget losses because of the regional disparity in prices for the same medicines. Burkitbayev said the Kazakhstani

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system of pharmaceutical state procurement is not transparent, because the regional departments of health do not report to the Ministry of Health on how the regional money is spent.

SK-Pharmacia's goal is to save the government money, support local producers, and attract investors to set up domestic production facilities.

TENDER PROCESS FAVORS LOCAL COMPANIES

¶14. (SBU) Burkitbayev explained the elaborate tender rules designed to give local tender participants unprecedented preferences and admitted that foreign producers are in a disadvantageous position compared with local producers. However, this measure is designed to encourage foreign companies to set up production facilities in Kazakhstan. He cited one foreign company that successfully won a tender: Nobel Almaty Pharmaceutical Factory won the tender for two lots, and it is 100 percent Turkish.

GOVERNMENT SPEEDS UP IMPLEMENTATION

¶15. (SBU) Burkitbayev said the original concept of the single-distributor system stipulated a gradual transition from the current procurement system. However, the Government decided to speed up the process, though he did not explain why. This year, 27 out of 600 medicines will be purchased for public hospitals through the single distributor system, and SK-Pharmacia selected one private distributor to deliver the medicine to hospitals across the country.

In 2010, SK-Pharmacia will procure all 600 medicines and will contract with several private distributors to deliver purchased medicines across the country, since no one private distributor is capable of handling all the deliveries nationwide.

AMERICAN COMPANY SAYS DISTRIBUTION IS THE PLAN'S WEAK LINK

¶16. (SBU) Vadim Efimenko, Kazakhstan representative for the American pharmaceutical company UniPharm, which sells nutritional supplements and over-the-counter medicines, told Regional Environmental Officer that the key to the government's new procurement system is distribution. He predicted that it will be difficult to set up an efficient distribution system, which will require a huge storage capacity and must send drugs even to small villages in remote regions. It takes UniPharm up to three weeks to deliver products to

remote villages. Efimenko said distribution costs typically add 25 percent to the final cost of medicines. He believed the government could further reduce pharmaceutical costs by reducing customs duties and VAT, currently set at 10 percent and 13 percent.

¶17. (SBU) Efimenko was critical of the government's five-year guaranteed, fixed-price contract. The recent devaluation of the tenge caused costs to jump 25 percent, and some of UniPharm's American suppliers are demanding that UniPharm reimburse them for the losses due to devaluation. He believes that such long-term contracts pose a serious risk to potential investors unless there is a mechanism in the contracts that can provide compensation due to devaluation.

PLAN AS ENVISIONED WILL NOT ATTRACT INVESTMENT

¶18. (SBU) Efimenko also questioned the nature of the investment that the new program would attract. Producers of low-tech medicines (vitamins, energy supplements, etc.) can easily set up shop. However, high-tech pharmaceuticals (certain antibiotics, insulin, tuberculosis medicines, etc.) will require substantial investment. The Central Asian market is still relatively small, and potential investors will have trouble justifying an investment in Kazakhstan. He noted that approximately 10,000 pharmaceutical products are registered in Kazakhstan, but only 3,000, or less than one third, are sold on a regular basis.

¶19. (SBU) Efimenko agrees that the Kazakhstani market for pharmaceuticals is stable and he foresees regular growth in the next

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few years. However, UniPharm is not planning to invest because the population base is too small and labor costs relative to Asia are too high.

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